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SIPDIS

DEPARTMENT FOR SA/INS

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SUBJECT: PROVINCIAL COUNCILS LACK FISCAL AUTONOMY TO
FULFILL RESPONSIBILITIES

Summary

1. (U) Provincial Councils PCs have limited revenue generating capabilities and are dependent on the central government for funding. Transfers to the PCs do not meet the amount required to fulfill their responsibilities. Corruption remains a widely recognized problem within the PCs. Consequently, PCs are unable to complete their initial goal of implementing local economic development programs. Their duties remain administrative offering little empowerment and political autonomy at the local level. END SUMMARY.

Devolution and 13th Amendment

2. (U) The minority Tamil community has often advocated for devolution of power away from the central government. The Tamils see devolution as a small step towards their larger goal of political autonomy in the North and East. The current PCs, were introduced to the country along with other provisions for political empowerment of Northern and Eastern Tamils, via the 1987 Indo-Lanka Accord. (Comment: As a consequence, in the eyes of many Sinhalese, the PCs system is linked unfavorably with Indian diplomatic pressure and Tamil demands for autonomy. End Comment.)

3. (U) Nine PCs were established through ratification of the 13th Amendment to the Sri Lanka Constitution. Currently only seven of the PCs collect tax revenue. The North and Eastern PCs have no revenue collection mechanisms as a result of the civil war. (Note: The LTTE collect taxes that go unrecognized by the central government. End Note.) PCs are given primary local authority in law and order, education, health, rural development, local services, and the implementation of provincial economic plans. Provincial police forces and civil services were to be set up to carry out these functions, including a provincial court systems to rule on subjects under the purview of the PCs. But police forces have not been devolved.

Structure of PCs

4. (U) The PCs as a system of transferring power to local governments, is a process of devolution rather than decentralization. Local governments have limited decision-making authority. The Governor, who is appointed by the President, holds the executive power of each PC. The Governor exercises his power directly through a Board of Ministers appointed from the Provincial Parliament. Provincial Parliament Members are elected by registered voters. These elections are the only source of downward accountability in the PC system. The financial responsibilities of the PCs rest with the Chief Secretary who is also appointed by the President. (Comment: The institutional design creates a void of downward accountability thus negating any benefits of decentralization. Little chance for the intended benefits of development through local participation remains. End Comment.)

5. (U) PC expenditure is funded from central government transfers and PCs tax revenue. All eight PCs are dependent upon these transfers to fulfill their responsibilities. The Finance Commission completes a needs assessment for every PC based upon the previous year's expenditure and makes a recommendation to the Ministry of Finance. According to Asoka G. Gunawardena, the Finance Commissioner, the budgets are often reduced by 3-5 percent resulting in under-funded PCs.

6. (U) The amounts transferred to each PC from the central government is determined by a simple formula of previous year expenditure minus expected tax revenue equals the government transfer. This formula does not account for inflation. Transfers to the PCs comprise 10 percent of central government expenditure. Additional funding for projects at local levels is distributed through the 44 line ministries, creating redundancy within government design. The central government uses the following four different transfer mechanism:

A. Block grants are used to fill in the gap between

expenditure needs and tax revenue shortcomings. Funds from the block grants are predominately used to fund salary payments and administration duties.

1B. Matching grants are used for capital expenditures.

1C. Criteria-based grants are used for capital expenditures as well.

1D. Special Project Development Grants (SPDG) are used for development projects.

Block grants account for 80 percent of transfer funds while matching grants, criteria-based grants and SPDGs account for the remaining 20 percent. The central government uses matching grants to encourage revenue generation by creating an incentive structure for increased tax revenue. Mr. A. Wijetunga, a Development Assistance Specialist with USAID, told Econoff that the matching grants scheme lack the funding required to create an effective incentive structure.

Tax Collection

17. (U) The 13th Amendment stipulates that PCs are allowed to collect taxes from a variety of points. The Business Turnover Tax (1 percent), Stamp Tax, Motor Vehicle Registration Fee and court fees generate the majority of PCs revenue. (Comment: PCs lack the human resource capacity to effectively collect taxes from all possible sources. End Comment.) The PCs have limited revenue generation capacity, as they are not allowed to create new forms of revenue. Additionally, the financial infrastructure is not in place in many rural areas to accommodate the record keeping needed to facilitate taxation. The Western Province generates 67 percent of all PC revenue generation due to the high concentration of commercial and industrial activities in the Western Province. Only three other provinces have "major" revenue collection.

18. (U) The PCs must seek the approval of Parliament in order to increase taxes. H.K. Dayapema, Deputy Chief Secretary of Finance for the Southern Provincial Council,

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told econoff and econ FSN that a number of PCs tried to raise the Business Turnover Tax rate to 5 percent on some items (e.g. liquor, cigarettes and electric items) but the central government did not approve and the tax hike was revoked. Dayapema said that PCs did not exercise their right to implement the Betting Tax, citing strong lobbying pressure by the gambling industry on the central government against the tax. Additionally, any measure to create a new tax would need to be approved by Parliament. To date the PCs have not implemented any new taxes due to a lack of confidence in parliamentary approval.

Limits on Expenditure

19. (U) Roughly 80 percent of the PCs budget is dedicated towards recurrent expenditure; administration costs, salaries and benefits. Salaries for the health and education sectors account for 92 percent of PCs recurrent expenditure. (Comment: The inability to leverage taxes coupled with the lack of authority to borrow money independent of the central government from international financial institutions limits PCs fiscal autonomy. End Comment.)

110. (U) The PCs are responsible for funding the local government system of 18 Municipal Councils, 37 Urban Councils and 256 Pradeshiya Sabhas (village councils). (Comment: The PCs were created to give decentralized powers to local governments, but retain little autonomy in determining expenditure distribution or fiscal capacity. End Comment.) Finance Commissioner Mr. Asoka Gunewardena told econoff that the PCs give stamp tax funds to the local governments. Mr. Arif Ismail Mohamed told econoff and econ FSN the PCs are forced to undercut the needs of the local governments as a result of their own lack of funding, claiming that 40 percent of the PC budget was lost to corruption and waste.

Corruption

11. (SBU) Claims of corruption against the PCs were supported by every source interviewed. Press reports describe the PCs as a "useless white elephant reeking with corruption." The Finance Commission is responsible for monitoring PC fiscal activities, but the Commission is "weak and has no real power" according to Central Bank contacts. (Comment: While at the Finance Commission, Embassy personnel observed an office running on a minimal budget with few modern technologies resulting in severely limited capabilities. End Comment.) The Finance Commissioner admitted to have little power to stop corruption and considered it a serious problem in the PC system.

Comment

12. (SBU) The PCs were created as a mechanism to quell the ethnic divisions in the country and used as a conflict mitigation tool. They appear to be purposely under funded and restricted more as a political power play than as the result of a lack of human capacity at the local level. Sources continually cited "politics" as the motivations behind the lack of funding. Given the origins of the PCs, it is difficult to imagine the central government providing the necessary autonomy or fiscal capacity required for the PCs to adequately serve their constituents even after reporting 22 percent gains in central government tax collection for the first half of 2005. Additionally, Government of Sri Lanka reports indicate that PCs will be expected to participate in future disaster relief efforts, which seems ill advised due to a lack of commitment towards PCs by the central government. END COMMENT.
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